

GAO

Report to the Ranking Minority Member,
Permanent Subcommittee on
Investigations, Committee on
Governmental Affairs, U.S. Senate

September 1995

SMALL BUSINESS ADMINISTRATION

8(a) Is Vulnerable to Program and Contractor Abuse



Office of Special Investigations

B-261485

September 7, 1995

The Honorable Sam Nunn
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate

Dear Senator Nunn:

On October 5, 1994, you requested that we determine whether the Small Business Administration's (SBA) 8(a) program is being exploited by individuals or corporations that have used illegal or improper means to participate in and benefit from the program. SBA's 8(a) program is designed to develop and promote businesses that are owned and controlled by socially and economically disadvantaged individuals. You were concerned that weaknesses in program management and administration identified in our September 1993¹ report may make the 8(a) program vulnerable to abusive activities.

You asked us to determine, within the context of case studies, whether abuses such as the following have occurred in the 8(a) program.

- Has the improper participation of 8(a) firms resulted in their being awarded contracts for which they were otherwise ineligible, and have 8(a) firms misrepresented themselves to enter and/or stay in the program?
- Have any 8(a) contracts been inappropriately awarded to firms that were ineligible because they exceeded size standard restrictions? Has SBA allowed firms to remain in the program after their increased size indicated that they should be graduated?
- Have federal contracting authorities improperly used the Indefinite Delivery Indefinite Quantity (IDIQ)² contracting option to noncompetitively steer 8(a) contracts that should have been competitive?

¹Small Business: Problems Continue With SBA's Minority Business Development Program (GAO/RCED-93-145, Sept. 17, 1993).

²IDIQ contracts are used when agencies do not know the precise quantity of supplies or services to be provided and consequently are able only to estimate a minimum value. For purposes of IDIQ contracts, the guaranteed minimum value was \$3 million for service contracts and \$5 million for manufacturing contracts. SBA recently amended its 8(a) regulations to eliminate the potential abuse of IDIQ contracts to avoid competition. 13 C.F.R. § 124.311(a)(2) (1995) requires agencies to competitively award any contract whose total value exceeds \$3 million for service contracts and \$5 million for manufacturing contracts. Effective August 7, 1995, the applicable threshold amount will be applied to the agency's estimate of the contract's total value, including all options. The minimum value of the contract will no longer be used.

To develop our case studies, we reviewed SBA application, eligibility, and participation documents of the top 25 8(a) contractors in terms of total dollars awarded for fiscal year 1992. (See app. II.) We looked for indicators, or red flags, of potential regulatory violations and criminal misconduct. We initially selected four firms for investigation based on the strength of the indicators we found. Due to time constraints and the destruction of records compiled for one firm as a result of the Oklahoma City bombing tragedy, we narrowed our investigation to two firms—I-NET, Inc. of Bethesda, Maryland, and Technical and Management Services Corporation (TAMSCO) of Calverton, Maryland—for further investigation.

I-NET and TAMSCO: An Overview

I-NET, Inc. is a high technology corporation that provides federal agencies with computer systems and support services. For fiscal year 1992, it was the third largest recipient of 8(a) contract awards, which totaled over \$65 million. During its nearly 10-year (Sept. 20, 1984, to June 16, 1994) program participation, I-NET obtained 145 8(a) contracts totaling at least \$508 million. At least 126 of the 145 contracts were awarded noncompetitively.

TAMSCO is a high technology corporation that provides computer systems and support services to federal agencies and large Department of Defense contractors. For fiscal year 1992, it was the ninth largest recipient of 8(a) contract awards, totaling over \$30 million. During its program participation from May 14, 1984, until September 18, 1993, TAMSCO obtained 108 8(a) contracts totaling at least \$356 million. At least 82 of the 108 contracts were awarded noncompetitively.

Results in Brief

I-NET and TAMSCO were among the firms that were initially recommended for nonacceptance into the 8(a) program because of eligibility questions concerning who actually controlled each firm. SBA had questions that were never fully answered about whether I-NET and TAMSCO were owned and controlled by socially and economically disadvantaged individuals, as defined by 8(a) program regulations. Based on our review of SBA documentation and our interviews with SBA officials, we questioned SBA's justification to accept I-NET and TAMSCO into the program.

On at least two occasions after entry into the program, I-NET's owner did not inform SBA about the true equity ownership in the firm, in violation of

SBA regulations. I-NET also misrepresented information to SBA about its owner's personal qualifications: I-NET's owner falsely certified on a résumé submitted to SBA with her 8(a) application that she held an Associate of Arts (AA) degree in computer science and technology. SBA took no action when it learned of these misrepresentations.

I-NET received 8(a) contracts totaling millions of dollars after it had grown too large for continued 8(a) program participation. To remain eligible for contracts, I-NET excluded items from its financial statements, understating its total revenue; and it represented itself as a company at financial risk, although SBA found that I-NET's access to credit was considerable. Further, SBA allowed I-NET to stay in the program and obtain contracts after it determined that I-NET had achieved the program goals.

In our investigation of TAMSCO, we determined that U.S. Coast Guard officials had directed a sole source contract to TAMSCO, thus avoiding federal competition requirements. Coast Guard officials changed the contract's classification code to one for which TAMSCO qualified and altered the minimum value of the contract from the original solicitation by lowering the total number of labor hours by 46 percent. Such changes allowed the Coast Guard to award a sole source IDIQ contract to TAMSCO and offer the company, according to a Coast Guard official's written notes, a "graduation present."

Background

Previous GAO Findings

In March and April 1995, as a part of our continuing work on the 8(a) program, we testified³ that the program has continued to experience problems in achieving its objectives. As the value and number of 8(a) contracts continue to grow, the distribution of those contracts remains concentrated among a very small percentage of participating 8(a) firms, while a large percentage get no awards at all. This is a long-standing problem. For example, in fiscal year 1990, 50 firms representing fewer than 2 percent of all program participants obtained about 40 percent, or \$1.5 billion, of the total \$4 billion awarded. Of additional concern is that, of the approximately 8,300 8(a) contracts awarded in fiscal 1990 and 1991 combined, 67 contracts were awarded competitively. In fiscal year 1994,

³Small Business: Status of SBA's 8(a) Minority Business Development Program (GAO/T-RCED-95-149, Apr. 4, 1995) and Small Business: Status of SBA's 8(a) Minority Business Development Program (GAO/T-RCED-95-122, Mar. 6, 1995).

the top 50 firms represented 1 percent of the program participants and obtained 25 percent, or \$1.1 billion, of the \$4.37 billion awarded, while 56 percent of the firms got no awards. In fiscal year 1994, \$383 million in contracts were awarded competitively.

SBA Award and Eligibility Data for Fiscal Year 1992

The eligibility and participation files for the top 25 8(a) contract award recipients for fiscal year 1992, from which we selected I-NET and TAMSCO, showed that approximately \$816 million, or about 22 percent of the total 8(a) contract dollars awarded that year,⁴ went to the top 25 firms. These firms had obtained, as of May 1995, a total of \$4.9 billion in 8(a) contracts. Of these firms, three were Black-owned; eight were Hispanic-owned; six were Asian-owned; and five were Native American-owned.⁵

SBA had initially recommended that 15 of these 25 firms not be accepted into the program because the applicants did not meet eligibility standards for one or more of the following reasons:

- The ownership or control of the firms resided in individuals other than those who were applying (8 firms).
- The owners were not economically disadvantaged (2 firms).
- The firm was acting as a broker/dealer in violation of the Walsh-Healy Act (1 firm).
- The firms lacked the financial capability to perform on the contracts they wished to bid on (5 firms).
- SBA could not provide adequate contract support for the firms to succeed (3 firms).⁶

These recommendations were overruled, in some cases by high-level SBA officials, despite the fact that some of the firms had not been recommended for acceptance up to three times previously for the same reasons. As of May 1995, 18 of these 25 firms had exited from the program; yet at least 17 are still performing on contracts awarded while they were in the program. According to SBA, the total dollar value of contracts awarded

⁴These data, the most current available when we initiated our investigation, were compiled from the Federal Procurement Database System, operated by the General Services Administration. We did not attempt to verify the data.

⁵SBA could not provide the eligibility files for 3 of the 25 firms.

⁶The cited numbers exceed 15 because some firms were not recommended for acceptance for multiple reasons.

to the firms initially not recommended for participation in the program is at least \$2.9 billion.

An SBA Office of Inspector General (OIG) audit report (Sept. 1994) also questioned the continued eligibility of large 8(a) firms in the program and identified some of the same causes. In its report, it cited findings wherein

- individuals in the program had overcome their economic disadvantage but remained in the program by understating their net worth;
- SBA officials had miscalculated the net worth;
- high personal income was also not considered in the evaluation of net worth; and
- individuals remained in the program because either the firm's equity, the owner's personal residence, and/or the spouse's net worth were not considered factors in determining the owners' net worth. Consequently, individuals could remove equity from the firms and use it to purchase expensive personal residences exempt from net worth evaluations.

SBA Admitted I-NET and TAMSCO to the 8(a) Program Although It Questioned the Firms' Negative Control

According to SBA 8(a) regulations, negative control is the lack of power by a program participant to control a firm's operations. For the 8(a) program, SBA regulations state that a program applicant must unconditionally own at least 51 percent of the firm and control its operations.⁷ Control is further defined as a condition that would not allow a noneligible person to benefit from the program or subjugate the control of the firm's operations. SBA had concerns about negative control issues at both I-NET and TAMSCO, but it ultimately admitted both firms to the 8(a) program.

I-NET—Negative Control Issues

SBA officials recommended denying I-NET acceptance into the program in four separate instances, but other SBA officials overruled these recommendations. SBA officials had determined that I-NET's owner and president, Mrs. Kavelle Bajaj, lacked the technical and managerial experience to run a high technology computer firm. They also determined that, rather than Mrs. Bajaj, Mr. Bajaj, a recognized expert in the field, would actually control and run the firm's operations.

A former I-NET Vice President for Marketing and Operations told us that Mrs. Bajaj lacked the technical and managerial skills needed to run a computer company and that he was hired by Mr. Bajaj in January 1985 to help start and run the firm and to "teach" Mrs. Bajaj how to run a business.

⁷SBA regulations provide that the program applicant shall control the 8(a) firm's board of directors either in actual numbers of voting directors or through weighted voting. 13 C.F.R. §124.104 (1995).

For this, Mrs. Bajaj gave the former vice president 24.5 percent of the company. Shortly after leaving the company in 1988, this individual was replaced by Mr. Bajaj, who was appointed Executive Vice President. Mr. Bajaj formally became I-NET's president after I-NET exited from the 8(a) program in 1994. On the résumé he submitted to SBA-OIG during its 1992 audit, Mr. Bajaj stated that he was "responsible for day-to-day operations" of I-NET. Mrs. Bajaj was adamant with us that she unconditionally owned and controlled the firm. However, Mrs. Bajaj provided no explanation when we asked her how she maintained control over I-NET while, at the same time, her husband represented that he had the day-to-day responsibilities for I-NET operations.

Further, a senior SBA official told us that the memorandum prepared by an SBA regional staff member recommending acceptance into the program used "circular reasoning" in overruling the District Office's objections to this firm. Other SBA officials who relied on the first official's analysis agreed that it was "double talk" that inadequately addressed the reason to overrule the recommended refusal. One stated that I-NET's admission to the 8(a) program was "questionable." Nevertheless, these officials stood by their decision to recommend accepting I-NET.

TAMSCO—Negative Control Issues

From the outset, SBA questioned the control that TAMSCO's nondisadvantaged (Caucasian) owner exercised over the disadvantaged (Hispanic) owner due to the structure of the board of directors, the owners' prior relationship, and their compensation. However, SBA allowed TAMSCO to participate fully in the 8(a) program.

SBA identified the ownership and negative control issue at TAMSCO during the application process and twice recommended that the firm's application be denied. SBA determined that the firm was owned by two persons, with the Hispanic owner having 51 percent and the Caucasian owner, 49 percent. SBA compared their résumés and other documentation in the 8(a) application and found that the Caucasian owner had previously held supervisory positions over the Hispanic owner and that the two-man board of directors, on which both served, allowed the Caucasian owner to have negative control over the Hispanic owner. SBA officials concluded that the firm should be rejected because the Caucasian owner would improperly benefit from the program.

We also found that the personal financial statements and other documentation showed that the Caucasian owner had a higher salary than

the Hispanic owner and that the firm was located at the Caucasian owner's residence. A former official of the firm told us that the two owners were "co-dependent" and functioned as equals. TAMSCO's president (the Hispanic owner) told us that (1) despite his previous relationship with the Caucasian owner, ownership was structured so that TAMSCO would be eligible for Small and Disadvantaged Business contracts and (2) it was agreed that he would maintain total control over the firm's operations.

The SBA official who overturned the two recommendations for denial had no answers or explanations as to why he had accepted TAMSCO into the 8(a) program over the prior objections of SBA officials concerning negative control. He also denied meeting or discussing the matter with TAMSCO's owners. However, the TAMSCO owners told us that they had had substantive discussions and meetings with him on the issue of negative control.

SBA Misled by I-NET Misrepresentations and Took no Action to Remove It From the Program

I-NET provided false and misleading information to SBA regarding its equity ownership in the firm, the owner's educational credentials, and the owner's citizenship status. Despite these misrepresentations, SBA did not terminate I-NET from the program or suspend its contracts.

I-NET Submitted False Statements About Equity Ownership

I-NET submitted false statements to SBA about its equity ownership. Documents, interviews, and a federal court case revealed that I-NET had entered into partnership agreements with two individuals in January 1985 for a total of 49-percent ownership interest (each with a 24.5-percent share) without disclosing these transactions to SBA, as required by SBA regulations.⁸

One of the 24.5-percent equity owners also owned another computer services company. At the time, SBA regulations prohibited a business concern in a related field from owning any equity in an 8(a) firm.⁹

⁸At the time, 13 C.F.R. § 124.1-1(e)(vii) (1985) stated that withholding information about changes in ownership could result in termination from the program. Mrs. Bajaj had also signed a program participation agreement in which she had agreed to notify SBA within 30 days of any changes in ownership. Current regulation 13 C.F.R. § 124.103(i) (1995) requires written approval from SBA to change ownership equity interests exceeding 10 percent.

⁹SBA SOP 80-05 ch. 2, ¶ 7(b)(5)(1982) and revised at SOP 80-05 ch. 2, ¶ 7(b)(4). Current regulation 13 C.F.R. § 124.103(h) (1995) prohibits more than 10-percent ownership in an 8(a) firm by a related concern.

Although I-NET repurchased this ownership interest within a year of its issuance, Mrs. Bajaj never informed SBA about this transaction.

Mrs. Bajaj submitted a false statement about I-NET's ownership status to SBA in January 1986, when I-NET notified SBA that 49 percent of the company's stock was unissued. However, 24.5 percent was still outstanding with the one remaining partner. Believing that SBA would approve only a 15-percent transfer of ownership, Mrs. Bajaj attempted to reduce the remaining partner's interest to 15 percent and privately negotiate away the remaining difference.

In 1988, Mrs. Bajaj submitted a second document to SBA, stating that 49 percent of the stock was "unissued," despite the outstanding 24.5-percent equity ownership by the remaining partner. She told us that she considered the stock unissued until a dispute with this partner over his ownership was resolved.

In August 1994, 2 weeks after agreeing to withdraw from the program, I-NET notified SBA that it intended to sell 20 to 25 percent of the firm's stock through a private placement offered through a large investment company. When SBA officials learned of the impending sale, SBA attorneys recommended against approving it because its terms would have relinquished control of the firm to the outside private investors.¹⁰ The terms of the transactions, according to the SBA attorneys who reviewed the documents, enabled the investors to have negative control over the firm's operations. SBA has not issued a decision, but I-NET completed the sale without a waiver from SBA, thus potentially jeopardizing its current 8(a) program contracts. The SBA Associate Administrator for Minority and Enterprise Development told us that the matter was being handled immediately; but, as of August 14, 1995, no final decision had been rendered.

I-NET Misrepresented Credentials to the SBA

Mrs. Bajaj provided false information about her educational credentials, which SBA relied upon, in part, for admittance to the 8(a) program. She certified on the résumé accompanying her 8(a) application to SBA in January 1983 that she had obtained an AA degree in Computer Science and Technology from Montgomery College in Rockville, Maryland. Transcripts

¹⁰13 C.F.R. § 124.317 (1995) requires that firms no longer in the program but still performing on 8(a) contracts immediately notify SBA upon entering into an agreement to transfer any ownership to another party. If SBA determines that the transfer would relinquish the ownership or control from the person upon whom program eligibility is based, a waiver from the SBA Administrator is required. Absent a waiver, the firm's contracts can be terminated.

from Montgomery College show that she never earned the stated degree. SBA denied I-NET's application for the 8(a) program in October 1983 because of lack of technical and managerial experience. Mrs. Bajaj again submitted a résumé with the same false information in a reconsideration appeal application later that month. According to a former I-NET senior executive, Mrs. Bajaj attached a résumé that contained the same false information to contract proposals submitted to agencies. In 1992, when the SBA-OIG audited I-NET, I-NET provided the OIG another résumé claiming she held the same nonexistent AA degree. Mrs. Bajaj admitted to us not having the degree and stated that she "naively" thought that the credits she had earned to obtain her Bachelor of Science degree in Home Economics from the University of Delhi, India, counted toward an AA degree in computer science and technology.

SBA documents show that SBA relied in part on Mrs. Bajaj's false information about the AA degree at the time when it was certifying I-NET for program participation. In an October 1993 document, the SBA Regional Counsel stated that the "original recommendation for I-NET's approval was based, at least in part, on false information submitted by the applicant regarding Mrs. Bajaj's degree." Although SBA officials acknowledged this fact in October 1993, I-NET remained in the program for another 9 months and obtained additional contract awards totaling at least \$13.5 million. When asked about this document, the Regional Counsel stated that the falsification was not itself sufficient to terminate the firm, despite SBA regulations that providing false information to SBA is grounds for termination from the program.¹¹

Mrs. Bajaj also misrepresented her citizenship on her first application on January 11, 1983. She said that she was a U.S. citizen, but she did not obtain her citizenship until May 13, 1983. (U.S. citizenship is a requirement for acceptance into the 8(a) program.) She told us that she thought she would be a citizen by the time the application was processed. She also said that although SBA had told her that she need not be a citizen at the time of application, she was concerned that her pending citizenship status would have held up her 8(a) application. I-NET was accepted into the program on September 20, 1984.

¹¹13 C.F.R. § 124.209(a)(19) (1995).

SBA Failed to Recognize in a Timely Manner That I-NET Had Exceeded Size Standards

SBA did not recognize that I-NET had provided misleading financial statements concerning its total revenues. Furthermore, I-NET misstated its financial condition as being at risk in efforts to continue 8(a) program contracts.

I-NET submitted financial statements to SBA that misrepresented its size by excluding certain revenues from the total sales, which allowed it to meet size standards for contracts in 1991 and 1992. I-NET explained the exclusion of this revenue in footnotes to its audited 1988 through 1990 financial statements, claiming that it was entitled to exclude these revenues because I-NET had earned no income on the revenues. SBA did not recognize or react to the information in the 1988 through 1990 financial statement footnotes until 1992.¹² These exclusions permitted I-NET to obtain at least 11 contracts for which it was not eligible.

However, I-NET included these revenues in its yearly total sales figures in submissions to an outside investment firm when it was seeking private outside investment. Our review of I-NET's 1989 and 1990 corporate tax returns, submitted to SBA, shows that I-NET's gross receipts as reported to the Internal Revenue Service were also substantially greater than those reported to SBA. In 1992, SBA found that the excluded revenue should have been counted for 8(a) size purposes.

Therefore, in early 1993, SBA considered terminating certain contracts on the grounds that I-NET was not eligible because it had exceeded its size standards. In response, I-NET submitted an Impact Analysis Statement to SBA in April 1993. The statement said, in part, ". . . (t)he banking industry continues to label I-NET and Kavelle [Bajaj] in a negative way . . . and maintaining adequate capital and credit are a constant challenge which leaves the company at risk."¹³ However, in reviewing the matter and determining if I-NET met early graduation criteria, SBA found that I-NET had a \$25-million line of credit with its bank, had obtained loans and financings exceeding \$2 million, and had sales approaching \$100 million per year. Based on its review, SBA did not find that I-NET was at risk. When asked about this apparent contradiction, Mrs. Bajaj told us that it was her view that \$25 million was not sufficient credit.

¹²SBA regulations require that an 8(a) firm certify that it is a small business for each contract that it receives. SBA is responsible for verifying the certification. 13 C.F.R. § 124.102(d) (1995) and 13 C.F.R. § 121.1102(a)(2) (1995).

¹³Even if it were true that I-NET was a "company at risk," this is not relevant to the issue of whether I-NET was a small business and therefore eligible to receive 8(a) contracts under SBA regulations.

During this same time period, however, I-NET did not portray itself as a company at risk when it sought outside investors. A written private placement memorandum about I-NET states that as of June 1993, I-NET had a backlog of over \$580 million in contracts and projected revenues through 1997 of about \$1.3 billion. Subsequent to our interview of Mrs. Bajaj, I-NET provided us a written response to the risk issue. It stated that, at the time the memorandum was written, I-NET “. . . had severe cash flow problems and was having difficulty securing credit.”

Furthermore, in December 1993, SBA determined that I-NET again had claimed erroneously that it lacked access to credit when it was appealing SBA’s October 1993 proposed early graduation action. In its review, SBA also determined that I-NET appeared to be misleading SBA by using inappropriate time periods to calculate earnings.

SBA Allowed I-NET to Remain in the 8(a) Program After It Exceeded Size Limits

Although SBA officials responsible for monitoring I-NET’s progress had become aware that I-NET had grown too large for continued program participation, SBA allowed the company to remain enrolled for almost 2 additional years. During this time, I-NET continued to obtain large contract awards.

In fact, 6 days prior to I-NET’s initially being recommended for early graduation in September 1992, it was awarded a \$134-million contract. The SBA official who approved the contract award was also responsible for initially recommending I-NET’s early graduation. When we interviewed him, he explained that, under SBA regulations, until a firm is officially out of the program, it can still obtain contract awards for which it is eligible. Although he wanted I-NET out of the program, he felt he could not deny contract awards until I-NET had either graduated or been terminated.

However, SBA regulations¹⁴ and a 1982 federal court decision,¹⁵ in conjunction with a Comptroller General decision¹⁶ on the same issue, concluded differently. Both the court and the Comptroller General determined that an 8(a) firm that has exceeded size limitations must have its 8(a) contracts suspended. The regulations also state that contracts can be suspended pending a termination action by SBA. When asked about this contradiction, responsible SBA officials responded by stating that SBA

¹⁴13 C.F.R. § 124.211(a) (1995).

¹⁵*Systems and Applied Sciences Corp. v. Sanders*, 544 F. Supp. 576 (D.D.C. 1982).

¹⁶*Matter of Computer Data Systems, Inc.* 61 Comp. Gen. 545 (1982).

lacked the proof required to terminate I-NET, despite regulations regarding actionable offenses for termination, which include providing false information to SBA—something that SBA concedes occurred.

In January 1993, the SBA-OIG provided a draft audit report to the SBA office responsible for I-NET, recommending that no further contracts be awarded to I-NET because it had exceeded its size standards and had provided incorrect information to SBA for its annual size-standard determinations. However, until I-NET left the program in June 1994, SBA awarded I-NET additional contracts totaling at least \$62 million.

U.S. Coast Guard Officials Directed a Noncompetitive IDIQ Contract to TAMSCO

In 1993, the U.S. Coast Guard directed a noncompetitive IDIQ contract with a maximum value of \$14 million to TAMSCO. During the preaward phase of the contract, Coast Guard contracting officials, who told us that it was always their intention to award the contract to TAMSCO, met with TAMSCO representatives and discussed the contract, competition thresholds, and Standard Industrial Classification (SIC) codes.¹⁷ The Coast Guard changed the original SIC code so that TAMSCO would be eligible for the award; used the IDIQ contracting option; and lowered the labor hours to avoid competition. Further, one Coast Guard official's notes referred to this IDIQ contract to TAMSCO as a "graduation present" from the 8(a) program.

Coast Guard Officials Changed SIC Code, Contract Type, and Labor Hours to Avoid Competition Requirements

Coast Guard officials changed the SIC code assignment and minimum contract value. Following these changes, TAMSCO was awarded a large noncompetitive IDIQ contract 1 day before its term was to expire in the 8(a) program in September 1993. Had the Coast Guard contracting officer's originally assigned SIC code been used, TAMSCO would not have been eligible for the contract because the company had exceeded the size standard for the originally assigned SIC code.

Based on notes that the Contracting Officer's Technical Representative (COTR) wrote during meetings between Coast Guard officials and TAMSCO, it appears that the Coast Guard officials and TAMSCO had concerns about the competition thresholds. In essence, we believe that they wished to avoid the \$3-million threshold required for competitive 8(a) service contracts. The Coast Guard lowered the labor hours, thus being able to award an IDIQ noncompetitive contract.

¹⁷SBA has established size standards for industries, which are defined in the classification categories of the Standard Industrial Classification (SIC) Manual.

Our analysis of labor costs determined that Coast Guard officials lowered the total number of labor hours in the contract by 46 percent from what was specified in the contract solicitation. Thus, the minimum contract value dropped below the \$3-million competition threshold, from \$4.6 million to \$2.1 million. We interviewed a Coast Guard officer involved in the contract award who also developed the original minimum contract value. When we asked him about a Coast Guard finding that if fully loaded labor rates had been used in the contract, the minimum value of the contract would have exceeded competitive thresholds, he had no answer. However, he stated that the Coast Guard officials had done everything possible to get TAMSCO the contract, including changing the SIC codes and using the IDIQ contracting option.

Coast Guard Officials Viewed Competition as Hindrance to Mission

The COTR also told us that the SIC code was intentionally changed to meet TAMSCO's eligibility and that the Coast Guard viewed competition of contract awards as a hindrance to furthering the mission. A draft of an internal Coast Guard memorandum, written to justify the contract award to TAMSCO, sheds light on Coast Guard attitudes about the use of competition and 8(a) sole source contracts. The COTR sent the memorandum—in electronic mail (e-mail) format—to another Coast Guard official for comment. The commenting Coast Guard official responded to the COTR's memorandum—also by e-mail—by interspersing his remarks in all capital letters. (See fig. 1.)

Figure 1: Draft E-Mail Memorandum Between the COTR and a Coast Guard Official

Other factors favoring TAMSCO include: (1) TAMSCO's sole source eligibility under 8(a). This eligibility extends until Sept 93. Only the IDIQ contract has to be in place by Sept 93. New tasks can be awarded until the contract expires, in 5 to 10 years. The advantages of sole source 8(a) contracts are many. Being sole source allows much quicker contract award than competitive contracts MAJOR FAUX PAS. G-A WILL EAT YOU ALIVE FOR EVEN THINKING THIS - MUCH LESS SAYING IT OUT LOUD. YOU MUST MAKE THE KO THINK OF THIS HIMSELF and is non-protestable. The CG does not have time to utilize the competitive contract process even if they cared to ABSOLUTE SUICIDE. ERASE IT. DESTROY THE DISK; DESTROY ANY COPIES. DON'T EVEN HAVE THESE WORDS IN YOUR MIND WHEN YOU TALK TO THESE PEOPLE (EVEN THOUGH THEY'RE ABSOLUTELY TRUE).

According to two former TAMSCO officials involved in the award, the COTR had provided them with a later draft of the internal memorandum to review before he submitted it to higher-level Coast Guard officials. One of the TAMSCO officials told us that providing TAMSCO the memorandum to review was inappropriate; the other felt uncomfortable with receiving the document because the Coast Guard was always careful not to release internal documents.

According to these two former TAMSCO officials and TAMSCO's president, while they did not think it improper for TAMSCO to provide information on the 8(a) program and other contracting procedures to the Coast Guard, they agreed that the Coast Guard should have been using its own contracting officials to obtain the information.

IDIQ Contract to TAMSCO Was Referred to as a "Graduation Present"

Notes that the COTR took during Coast Guard/TAMSCO discussions also referred to suggestions that the contract be awarded to TAMSCO as a "graduation present" before the end of TAMSCO's 8(a) program participation. For example, one note stated, in part, "IDIQ: Grad[uation] P[resent]. -eligible until grad from program Sept 18, '93." In other words, TAMSCO could get a sole source IDIQ contract as a graduation present until its graduation date of September 18, 1993. (See fig. 2.)

Figure 2: Excerpt From the COTR's Notes



* (4) IDIQ: grad pt. - eligible until grad from program
Sept 18, '93

In addition to the Coast Guard contract, TAMSCO obtained at least 22 other 8(a) awards within 2 weeks of its “graduation”¹⁸ from the program totaling at least \$63 million. Thirteen of the awards were IDIQ contracts from a number of government agencies, including the Coast Guard award.

Methodology

We began our investigation by reviewing the application, eligibility, and participation files for the top 25 8(a) contract award recipients for fiscal year 1992, as compiled in our 1993 report. These records were located in 10 SBA District Offices nationwide. The files for two firms were unavailable for review. A third file did not contain eligibility documents. We looked for indicators of potential regulatory violations and criminal misconduct.

We initially selected four of the firms for further investigation. However, the records we compiled for one firm were destroyed in the Oklahoma City bombing tragedy on April 19, 1995, and our investigation of another firm was not complete at the time of this publication. We then narrowed our investigation to two firms—I-NET, Inc. of Bethesda, Maryland, and Technical and Management Services Corporation (TAMSCO) of Calverton, Maryland.

We interviewed officials and reviewed documents from the SBA, Office of Inspector General; various SBA district and regional offices; SBA’s Central Office; U.S. Department of Transportation, Office of Inspector General; U.S. Coast Guard; Resolution Trust Corporation, Office of Inspector General; Defense Contract Audit Agency; Department of Justice; and the Federal Bureau of Investigation. We also interviewed current and former employees of the firms, subcontractors, representatives of financial institutions, and others.

¹⁸TAMSCO completed its program term on Sept. 18, 1993.

As requested, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Administrator of SBA and to others upon request. If you have any questions concerning this report, please call me at (202) 512-6722 or Robert H. Hast, Assistant Director for Investigations, New York Regional Office, at (212) 264-0982. Major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Richard C. Stiener". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Richard C. Stiener
Director

Contents

Letter	1
Appendix I The 8(a) Program	20
Appendix II Top 25 8(a) Firms Matrix	22
Appendix III Major Contributors to This Report	23
Figures	
Figure 1: Draft E-mail Memorandum Between the COTR and a Coast Guard Official	14
Figure 2: Excerpt From the COTR's Notes	15

Abbreviations

AA	Associate of Arts
COTR	Contracting Officer's Technical Representative
e-mail	electronic mail
GAO	General Accounting Office
IDIQ	Indefinite Delivery Indefinite Quantity
OIG	Office of Inspector General
OSI	Office of Special Investigations
RCED	Resources, Community, and Economic Development Division
SBA	Small Business Administration
SIC	Standard Industrial Classification

The 8(a) Program

Section 8(a) of the Small Business Act, as amended, established the Minority Small Business and Capital Ownership Development Program, or 8(a) program, to promote the development of small businesses owned by socially and economically disadvantaged individuals so that they could develop into viable competitors in the commercial marketplace. To be eligible for the program, a small business must be 51 percent unconditionally owned and controlled by one or more socially and economically disadvantaged individuals. The company must also meet the small business size standards established by SBA for the firm's industry as defined in the classification categories prescribed by the Standard Industrial Classification (SIC) Manual.¹⁹ SBA approves applicable SIC codes for participating firms. Participating 8(a) firms may have one or more SICs assigned to them by SBA. To be considered a small business and remain eligible for the program, participating firms must not have outgrown all their SBA-approved SIC codes. Size standards for each SIC code are generally defined by the firm's number of employees or its average annual gross sales.²⁰

Under the program, SBA acts as a prime contractor, entering into contracts with other federal agencies and then subcontracting work to firms in the 8(a) program. Firms in the program are also eligible for financial, technical, and management assistance from SBA to aid their development. Participating firms can stay in the program for up to 9 years.

The Small Business Act, as amended, and federal regulations define "socially disadvantaged" as those persons who have been subjected to racial, ethnic, or cultural bias because of their identities as members of groups, without regard to their individual qualities. Certain racial and ethnic groups such as Black Americans, Hispanic Americans, Subcontinental Asian Americans, and Native Americans are presumed to be socially disadvantaged. However, individuals in groups not cited in the act, who can demonstrate that they are socially disadvantaged, may also be eligible. SBA regulations define "economically disadvantaged" as socially disadvantaged individuals who are unable to compete in the free enterprise system because their opportunities to obtain credit and capital have been more limited than those of others in similar businesses. Further, program applicants must demonstrate a personal net worth that does not exceed certain limits so as to meet and maintain the criteria for an economic disadvantage.

¹⁹This manual is published by the Office of Management and Budget and assigns a numerical identifier for each industry.

²⁰13 C.F.R. § 121.601 (1995).

Appendix I
The 8(a) Program

Each 8(a) firm under SBA's regulations is subject to a program term of 9 years.²¹ However, SBA may also, under its regulations, "graduate" an 8(a) firm prior to the expiration of its 9-year program term if that 8(a) firm substantially achieves the target objectives and goals set forth in its business plan. To date, according to SBA, no 8(a) firm has graduated.

²¹The 1988 Amendments to the act created this limit. 13 C.F.R. § 124.303(b) (1995) grandfathered firms that participated prior to 1988 so that firms with fewer than 5 years' participation would obtain 5 more years.

Top 25 8(a) Firms Matrix

Rank	Company Name	8(a) Contracts	
		Fiscal Year 92	Total Value of 8(a) Contracts Awarded
1	Colsa Inc.	\$91,593,712	\$497,821,732
2	Yancy Minerals Inc	81,931,200	210,750,390
3	I-NET Inc	65,338,088	508,284,206
4	Meters Industries Inc	43,921,758	156,314,914
5	Weeminuche Construction Authority	39,611,263	65,706,219
6	NYMA Inc	37,526,951	234,569,348
7	Systems Engineering & Management Co	35,182,607	185,816,251
8	R J O Enterprise Inc	30,532,192	385,034,793
9	TAMSCO	30,369,392	356,439,719
10	National Systems and Research Corp	29,175,097	291,198,853
11	Sherikon Inc	29,166,605	77,431,185
12	Advance Sciences Inc ^a	28,279,092	54,479,536
13	Turtle Mountain Manufacturing Co	27,894,845	200,786,724
14	Systematic Management Services Inc	25,669,502	145,241,079
15	Modern Technologies Corp	24,146,726	225,118,715
16	Tresp Associates Inc ^b	23,555,918	93,907,403
17	Frontier Engineering Inc	20,989,268	275,253,836
18	Maden Tech Consulting	20,775,446	78,951,336
19	Piquiniq Management Corp	19,775,820	128,934,788
20	Galaxy Scientific Corp	18,876,444	118,071,790
21	Metrica Inc	18,826,263	82,476,450
22	Shadrock Petroleum Products	18,502,664	48,405,291
23	Hernandez Engineering Inc	18,265,616	106,104,461
24	Washington Consulting Group ^a	17,972,076	140,839,773
25	Applied Technology Associates Inc	17,901,795	278,756,205
TOTAL 8(a) AWARDS		\$815,780,340	\$4,946,694,997

^aSBA was unable to provide the files for these firms.

^bThe eligibility documents were missing from this firm's file.

Major Contributors to This Report

Office of Special Investigations, Washington, D.C.

Donald J. Wheeler, Deputy Director for Investigations
M. Jane Hunt, Senior Communications Analyst
Barbara W. Alsip, Communications Analyst

Boston/New York Field Office

Robert H. Hast, Assistant Director for Investigations
William D. Hamel, Special Agent
Anne Kornblum, Senior Evaluator

Dallas Regional Office

Jeannie B. Davis, Senior Evaluator

Denver Regional Office

Jennifer L. Duncan, Senior Evaluator

Atlanta Regional Office

Octavia Parks, Senior Evaluator
Johnnie E. Barnes, Senior Evaluator

San Francisco Regional Office

Steve Myerson, Assistant Director for Investigations

Kansas City Regional Office

Richard Clough, Senior Evaluator
Steve Pruitt, Evaluator

Cincinnati Regional Office

Daniel L. McCafferty, Senior Evaluator

Office of the General Counsel, Washington, D.C.

Barry L. Shillito, Senior Attorney
Leslie Krasner, Attorney Adviser

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

